

Internal Revenue Service
memorandum

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date: JUN 30 1988

to: Chief, Omaha Appeals MW:OMA:AP
Attn: Joseph M. Bilunas

from: Director, Tax Litigation Division CC:TL

subject: Technical Advice - [REDACTED] (TL-N-7123-88)

It has been requested that we provide technical assistance with respect to the above matter. The issues involved have been discussed with Joseph Bilunas of your office.

ISSUES

(1) Whether petitioner properly deducted in the [REDACTED] taxable year, the amount which it was obligated to contribute under a [REDACTED] agreement to a Voluntary Employees Beneficiary Association (VEBA) Trust for the funding of benefits to be provided in the next year;

(2) Whether petitioner properly deducted in the [REDACTED] and [REDACTED] taxable years, contributions made to the VEBA Trust at the end of those years to fund benefits to be provided in the next year.

CONCLUSIONS

We believe that there are substantial litigation hazards with respect to both issues and therefore, recommend that the matter be settled or conceded without issuance of a statutory notice of deficiency.

FACTS

On [REDACTED], the taxpayer entered into an agreement with [REDACTED] to establish a VEBA through which medical, dental, death and disability benefits for employees would be funded. The identical benefits were provided to employees prior to the establishment of the VEBA. These benefits were provided through the purchase of insurance both before and after the Trust was established. The taxpayer also entered into a separate Funding Agreement with [REDACTED], as trustee for the VEBA, on [REDACTED]. Under that agreement, it was agreed that: (1) The "projected plan costs and reserves" for the [REDACTED] plan year were \$[REDACTED]; (2) [REDACTED] "is now obligated to contribute said amount to the Fund for its initial

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contribution on or before [REDACTED]." This amount was paid to the Trust by the specified date. In addition, at the end of [REDACTED] and [REDACTED], the taxpayer contributed \$[REDACTED] and \$[REDACTED] respectively, in order to fund the projected costs for the succeeding year. These amounts were apparently expended by the trust by the end of the year for which the contribution was made.

The taxpayer is an accrual basis taxpayer. It fully deducted the amount required to be contributed under the [REDACTED] Funding Agreement in its [REDACTED] taxable year. It also fully deducted the amounts contributed in [REDACTED] and [REDACTED] in the taxable year contributed. The Commissioner proposes to disallow these deductions in their entirety in the year taken and to carryover those amounts to the next year.

DISCUSSION

The first issue is whether the taxpayer properly deducted (i.e., properly accrued) the contribution for the projected costs for the [REDACTED] plan year in the [REDACTED] taxable year. In our view, it appears that it did. What is crucial here is that while the taxpayer was not actually obligated to make payment until [REDACTED], it apparently irrevocably bound itself to do so in [REDACTED]. And, the courts have generally held that this is all that is required to satisfy the requirement under the "all events" test that the liability be fixed. See, e.g., Lukens Steel Co. v. Commissioner, 442 F.2d 1131, 1134-35 (3d Cir. 1971); Washington Post Co. v. United States, 405 F.2d 1279, 1283-84 (Ct. Cl. 1969); Rath Packing Co. v. Bacon, 255 F. Supp. 809, 812 (S.D. Iowa 1966). Moreover, there is no question that the other requirement of the "all events" test (viz., the amount of the liability is determinable with reasonable accuracy) has been satisfied since a set dollar amount was specified in the agreement. In short, there are substantial litigation hazards with respect to the [REDACTED] taxable year.

There are, in our view, significant hazards with respect to the [REDACTED] and [REDACTED] taxable years as well. First, the recent decision of the Supreme Court in United States v. General Dynamics Corp., 55 U.S.L.W. 4526 (April 22, 1987) respecting the "all events" test is not controlling. Thus, unlike the medical plan involved in that case, the plan here is funded through a separate trust. And, where a welfare benefit plan is so funded, the Service has essentially taken the position that the "all events" test is satisfied when the contribution is made to the

trust.^{1/} See Treas. Reg. § 1.162-10, § 1.419-1T, (Q&A-10(e)) & § 1.461(h)-4T (Q&A-1). Second, even though the contributions here created a reserve which had a useful life beyond the tax year involved, it will be difficult to convince a court that the reserves had a useful life "substantially" beyond that year as the regulations require for capitalization treatment. See Treas. Reg. § 1.419-1T (Q&A-10(b)) & § 1.461-1(a)(2). This derives primarily from the fact that the contributed amounts were expended by the Trust in the next year. See, e.g., Zaninovich v. Commissioner, 616 F.2d 429, 432 (9th Cir. 1980) (one-year rule for capitalization).

The economic performance rules of IRC § 461(h), which are apparently applicable to the [REDACTED] and [REDACTED] taxable years, are also of no help. Thus, the regulations specify that for welfare benefits provided through a welfare benefit trust, economic performance occurs when the contribution is made to the trust. See Treas. Reg. § 1.461(h)-4T, Q&A-1. Therefore, economic performance for purposes of § 461(h) occurred here in the years in which the contributions were made. Accordingly, the requirements of § 461(h) have been satisfied in this case.

Lastly, there are practical considerations which militate against issuing a statutory notice of deficiency in this matter. On December 1, 1986, the Service issued VEBA Audit Guidelines to the field for years ending on or before December 31, 1985. Under these guidelines, the subject contributions probably should have been presumed to be reasonable and hence, entitled to the automatic IRC § 7805(b) relief provided for under the regulations (see Treas. Reg. § 1.419-1T, Q&A-10(c)). See Guidelines, at 3-4.

^{1/} And, as a technical matter, this would appear to be the correct conclusion since payment to a welfare benefit trust plainly fixes the liability and the amount of that liability (that is, the contribution made) is clearly determinable with reasonable accuracy.

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If you need any further assistance in this matter, please contact David Mustone of this Division at FTS 566-3407.

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